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## Waarborgfonds Sociale Woningbouw

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### Table Of Contents

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Major Rating Factors

Rationale

Outlook

Government Support And Application Of GRE Methodology

The Framework Of Support For WSW Is A Key Rating Strength

Business Description

Business Performance

Risk Management

Management And Governance

WSW's Capitalization And Collateral Support

Related Criteria And Research

# Waarborgfonds Sociale Woningbouw

## Major Rating Factors

### Strengths:

- Our view of the "almost certain" likelihood that the State of the Netherlands and the Dutch municipalities would provide timely and sufficient extraordinary support in times of financial need.
- Very strong ongoing government support for the social housing sector.
- The agreement between the Dutch central government and municipalities to provide interest free loans to WSW, should capital fall below 0.25% of guaranteed obligations.

### Issuer Credit Rating

AA+/Stable/--

### Weaknesses:

- Increased stress on housing association cash flows can potentially weaken their credit quality, increasing the likelihood of the WSW guarantee being called.
- Ongoing reforms affecting the regulation and funding of the social housing sector may create some transition risk, but this is unlikely to be material.

## Rationale

The long-term rating on Waarborgfonds Sociale Woningbouw (WSW) is equalized with that on the State of The Netherlands, reflecting Standard & Poor's Ratings Services' view of an "almost certain" likelihood that the government would provide timely and sufficient extraordinary support to WSW in the event of financial distress.

WSW is a not-for-profit private foundation that guarantees loans provided by lenders to Dutch social housing associations. This helps keep the cost of funding low for housing associations, enabling them to invest more in social housing provision.

In accordance with our criteria for government-related entities (GREs), our view of "almost certain" likelihood of extraordinary government support is based on our assessment of WSW's:

- "Critical" role for the government, based on our view that WSW indirectly provides a key public service by keeping funding costs of housing associations at a minimum--a role that we believe could not be readily undertaken by another private entity; and its
- "Integral" link with the Dutch government. We view WSW as having a special public status, given the government's ultimate responsibility for ensuring WSW can meet its obligations.

Besides the likelihood of extraordinary support in times of stress, the rating also reflects the very strong support provided by the Dutch system for housing associations going through significant stress. Although ongoing reforms may affect the regulation and funding of the social housing sector, and in turn may create some transition risk, we think this risk is unlikely to be material.

Our assessment is also informed by the very strong three-tier security structure available to WSW in terms of its access

to liquid funds in times of need. WSW has its own risk capital of about €500 million, and it also has access to callable committed capital from the associations of about €3.3 billion. In addition, the Dutch central government and municipalities, as backstop guarantors, are obliged to provide interest-free loans to WSW if its capital falls below 0.25% of guaranteed debt. We estimate this figure is currently 0.57%.

The rating on WSW is also supported by what has generally been its strong operational performance, despite a reported €14.6 million deficit in 2013. This was largely due to paper losses on its investment portfolio, which we understand have since recovered, and a provision for its liability to pay backdated corporation tax (estimated at €10.7 million). Looking ahead, we understand that WSW's ongoing liability for corporation tax is likely to be much smaller, based on 20% of its net surplus. On a cash flow basis, WSW's operating performance remained solid, as in previous years.

We also note there was a fall in demand for its services, with only €5.5 billion of new business written in 2013, compared with €9.5 billion in 2012. New demands on housing associations' cash flows, such as the recent levies that have been imposed, coupled with a continued subdued housing market, are likely to continue to reduce housing associations' appetite for capital investment, and hence the demand for WSW's guarantees.

### Liquidity

WSW has access to risk capital (free cash available to service obligations) estimated at €500.4 million in the current year, to meet guarantee obligations that may arise. Although this only comprises 0.57% of estimated guaranteed debt, WSW also has access to callable capital of up to €3.3 billion and unlimited access to interest free loans from the central government and municipalities in equal parts. Under the terms of the agreement, there can be at most a 75-day delay between a request being made and the central government and municipalities making these funds available. However, we understand from the government that these funds will be made available in a timely manner such that WSW receives the funds it needs.

### Outlook

The stable outlook reflects our opinion that there will be no deterioration in the likelihood of extraordinary support from the State of the Netherlands, despite the ongoing reforms to the social housing sector. The sovereign credit rating on The Netherlands remains the upper limit for the rating on WSW.

We could lower the rating as a result of a weakening of government support for WSW. This might arise following a change in the current legal agreements around the provision of minimum funding requirements, or our assessment that interest-free loans will be made available on a timely basis for WSW. This could lead us to revise our opinion of the likelihood of timely and sufficient extraordinary support in times of stress, which could lead us to lower the rating. We do not consider this likely at this time, however.

Alternatively, we could either lower or raise the rating if we changed the sovereign rating on the State of the Netherlands.

## Government Support And Application Of GRE Methodology

In accordance with our criteria for GREs (see "Related Criteria And Research"), our view of a "almost certain" likelihood of timely and sufficient extraordinary government support in times of stress is based on our assessment of WSW's "critical" role and "integral" link to the Dutch government. Discussions with the Ministry of the Interior and Kingdom Relations have also informed our judgment.

In our opinion, WSW plays a critical role in providing a key service that cannot be easily provided by a private entity, unless it were to have similar agreements relating to extraordinary support signed with government. WSW aims to keep funding costs to a minimum for housing associations that are key to delivering the housing policy mandate for the Dutch government. Although WSW is an independent foundation, it has a long history of working closely with the Central Fund, the Ministry of Finance, and the Ministry of the Interior and Kingdom Relations, which is responsible for social housing in The Netherlands.

Further, the central government and municipalities have agreed to provide interest free loans to WSW if its capital falls, or is forecast to fall, below 0.25% of guaranteed loans on the balance sheet. We also believe that a default by this GRE could negatively affect public sector banks and the housing sector in general. Public sector banks' largest exposure is to the housing sector, and should WSW default, the risk weighting on all these loans would need to be reviewed and could potentially lead to increased capital requirements.

Additionally, a default by one housing association could potentially raise the cost of funding for the sector and therefore reduce the amount of investment that housing associations find affordable, ultimately hindering some of the government's public policy goals. In our discussions with representatives of the Ministry of the Interior and Kingdom Relations, the government asserted the importance of WSW's role and reiterated its intention to support the organization, if and when required, on a timely basis.

Although WSW is an independent, private foundation, we see it as integrally linked with the Dutch government because of its special public status, demonstrated by the extremely strong backstop agreement and the stated intention of the government and municipalities to provide timely support in all circumstances. As a result, although the government does not have any representation on WSW's board, it is able to exercise control over WSW's operations by requiring that certain information be provided on a regular basis, and providing approvals for certain resolutions taken by the executive board. WSW is required to provide annual budget and cash flow forecasts to the central government. Further executive board resolutions relating to amendments to WSW's constitution, adoptions of the investment policy, or resolutions regarding the setting of discount fee rates must be approved by the central government and the association of Dutch municipalities.

## The Framework Of Support For WSW Is A Key Rating Strength

Public housing in The Netherlands is an important public policy tool and has been so for generations. The government designed-framework provides specific ongoing support to all housing associations using two important organizations: the Central Fund and WSW, working closely with the Ministry of the Interior and Kingdom Relations. We understand

that under upcoming reforms, the Central Fund may be brought within the Ministry, while retaining much of its autonomy. We believe the continuity of regulatory oversight would be likely to be preserved through such a transition.

### **The three-tier security support structure of WSW**

To ensure it can honor its obligations, WSW can fall back on three different levels of support. First, WSW has its own risk capital of €500.4 million (estimated for 2014). Risk capital is calculated as the value of investments at the lower of cost or market price plus cash, less creditors, accruals and deferred income and long-term liabilities. Second, if risk capital is insufficient and additional capital is required, WSW can call on the associations to contribute additional capital, up to the level that the participating associations have committed to pay, which is up to 3.85% of their current outstanding debt. WSW is expected to call for the additional capital to be paid if the fund's own capital falls to less than 0.25% of the total guaranteed capital. Thus, in theory, about €3.3 billion can be made available, if required, based on guaranteed obligations estimated for 2014. However, we believe this amount would take time to gather.

The third tier of support for WSW is provided by the two backstop agreements--one signed by the central government and WSW, and the second signed by the municipalities and WSW. If WSW's capital remains less than 0.25% of total guaranteed obligations after the participants' committed capital contributions have been called, the central government and municipalities are contractually bound to contribute equally to provide interest-free loans to WSW to meet this capital requirement. The backstop guarantee remains in place until it is terminated by the government and such termination would only affect new loans after that decision (and after a specified termination period).

While we believe that this support from the central government and municipalities is likely to be timely, due to the technicalities of the legal agreement there could be several days (up to 75) between the request and before the loan must be provided. Nonetheless, we believe that there is an almost certain likelihood that the government and municipalities will ensure that WSW has sufficient cash to meet any calls on its guarantee obligations on time.

### **The supporting role of the central housing fund**

The Central Fund, set up by the Dutch government in 1988, provides assistance to any housing association in financial difficulties that stem from structural rather than liquidity issues. Assistance may be via interest-free loans or lump-sum payments to help associations implement reorganization plans.

The Central Fund is itself funded by mandatory fees paid by housing associations. It is responsible for the financial supervision of the housing sector and individual housing associations. As discussed above, we understand that the Central Fund is likely to be brought within the Ministry, while some aspects of its role assessing housing associations' requirements for extraordinary support may be transferred to WSW, which would then advise the Ministry. The Ministry of the Interior and Kingdom Relations has the power to provide extraordinary support in cases of financial distress, and to replace board members and appoint interim managers to a troubled association.

### **Creditworthiness of Dutch municipalities**

The statutory and institutional framework that regulates the interaction between the central government and municipalities results in high credit quality for Dutch municipalities. We consider that the local government sector in The Netherlands benefits from the stable and supportive financial and legal framework that has been established by the central government.

Dutch municipalities have a wide range of responsibilities under the Social Support Act that came into force in 2007. The roles and responsibilities and the interaction with the central government is currently being reassessed. We still believe, however, that there will be adequate financing and sufficient support provided to municipalities to fulfill their obligations and to provide interest-free loans when required by WSW.

Furthermore, associations are expected to inform related municipalities about the types of activities they engage in on a yearly basis. In the event of conflicts that arise within the municipality, a minister can intercede to resolve the conflict.

## Business Description

Created in 1983 by the Federation of Dutch Housing Associations, WSW is a not-for-profit private foundation set up to guarantee the debt of Dutch social housing providers taken to fund social housing projects. From 1994, its guarantees have been extended to cover many of the housing association liabilities previously guaranteed directly by both central and local governments and referred to as "indemnified loans." WSW currently guarantees the loan obligations of 97% of Dutch housing associations (371 of a total of 379 associations as of December 2013) and the value of its guaranteed portfolio stands at €86.2 billion as of December 2013 (€87.4 billion in 2012). WSW forecasts this to fall to about €85 billion by 2017, reflecting housing associations' reduced appetite for capital investment. As of December 2013, guaranteed loans to associations that each have outstanding debt of over €1 billion accounted for \$29 billion (34%) of WSW's guarantees.

## Business Performance

In 2013, WSW guaranteed about €5.5 billion of loans, of which 54% related to fixed-interest loans and 46% to floating-rate loans. Over 2013, housing associations repaid €6.7 billion of principal, leading to a reduction in guaranteed debt. This contrasts with previous years, in which debt has been increasing.

WSW depends on housing associations being able to service their own debt; otherwise it risks being called upon to honor its obligations. We understand that the introduction of the landlord levy and has impaired housing association cash flows, which could continue to affect the volume of WSW's new business. This could also increase the likelihood of a call on WSW's guarantee.

WSW's revenues comprise fees paid by participating housing associations and returns from the investments that it holds. The fees and investments help maintain WSW's capital base and support the level of risk capital. Investment income, however, is quite volatile, reflecting the sensitivity of WSW's bond portfolio to interest rates. In 2013, WSW reported paper losses on investments of €21 million, resulting in a net investment loss of €3.6 million, but we understand that this loss has since been recovered (see Table 1).

General expenditure levels remain broadly stable. That said, we understand that WSW is likely to start paying corporation tax, backdated to 2008. In relation to this, WSW has filed an appeal against the decision of the Dutch Tax & Customs Administration. While awaiting the outcome of the appeal, WSW and the Dutch Tax & Customs

Administration have negotiated an out-of-court settlement of the dispute and discussed a financial compromise. However, no agreement has been reached, and the appeal proceedings will be continued in 2014. Consequently, WSW has recognized a provision for corporate income tax liabilities in respect of the period 2008-2013, amounting to €10,657,000, representing 50% of the maximum tax charge of €21,314,000 for the years 2008-2013.

Due the recognition of the unrealized investment losses and the tax liability, WSW posted an accruals deficit of €14.6 million in 2013, contrasting with a healthy surplus of €29.7 million in 2012. On a cash basis, however, performance was similar, with cash flow from operations at €17.7 million in 2013, only down slightly from €19.4 million in 2012.

**Table 1**

<b>Waarborgfonds Sociale Woningbouw Financial Statistics, 2008-2017f</b>										
<b>(Mil. €)</b>	<b>2017f</b>	<b>2016f</b>	<b>2015f</b>	<b>2014f</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>
<b>Profit and loss account</b>										
Contributions from participants	17	16	16	15	14.1	12.5	10.3	9.2	7	6
Results on investments	19	18	17	16	(3.6)	30.5	13.6	6.4	26	32
Expenditures	16	16	15	16	25.1	13.3	9.1	8.9	9.4	9
Result for the year	20	18	18	15	(14.6)	29.7	14.8	6.7	23.6	29
<b>Balance sheet</b>										
Long term investments	567	547	529	510	503.8	502.9	477.7	465	462	440
Current assets and cash	17	17	17	18	20.3	25.2	568.8	16	13	12
Fixed assets	2	2	2	2	1.5	1.5	1.7	2	1	1
Current liabilities and financial leases	2	2	2	2	13.4	2.7	551	1	0	1
Capital	584	564	546	528	512.2	526.9	497.2	482	476	452

f--Forecast. Numbers are rounded. Source: WSW.

## Risk Management

WSW is in the process of overhauling its risk management and internal control systems. WSW regards the assessment, monitoring, and management of risks related to its security structure as a core function.

Credit risk assessment is a crucial part of WSW's activity. Insufficient monitoring can result in unexpected calls for WSW to honor its obligations. As a significant number of loans have bullet maturities, an unexpected default could require WSW to honor a large obligation. WSW focuses on cash flow analysis and applies various stress tests that inform WSW's judgment on likely calls on the guarantees provided. WSW also assesses the business and financial risk of participating housing associations. Each association is given an internal risk rating/class ranked on a scale from 1 to 22, one representing the strongest credit. Any credit with risk classed between 14 and 22 is more stringently monitored by a special account management office. Presently, 19 entities fall into this category.

WSW pays stringent attention to investment risk to protect the value of its risk capital, which must be available to honor its obligations at short notice. It pursues a conservative investment policy, under which at least 95% of the investments must be invested in bonds. As of December 2013, at least 60% were held in 'AAA' rated paper and about 36% in 'AA' rated paper.

Finally, operational risk management is crucial to ensure that WSW is able to process all the data, monitor its portfolio, and process claims in a timely manner. It invests significant amounts in its business processes and monitors these closely.

## Management And Governance

The Supervisory Board oversees the work and policies pursued by the Executive Board, of which risk management forms the core concern. The supervisory board comprises five members. Two (including the chairman) continue to be nominated by AEDES--the trade association for Dutch housing associations--and one member has been appointed by the Participants Council. The other two are publicly recruited. The close connection between WSW and housing associations is maintained via its links to AEDES. Further, the board encourages its executive to maintain close links with the Ministry of the Interior and Kingdom Relations, the associations of Netherlands municipalities, and the Central Fund.

Following the departure of the CEO in 2013, the executive team is led by Mrs. Birgitte Van Hoesel-Snel, who joined the organization in 2012 and who was previously a board member of a housing association, and Mr. Erik Wilders, who joined in September 2013 and has worked as a director at the Dutch State Treasury Agency. Both are responsible for operations and for redefining the framework within which WSW operates, including management of operational and investment risk. With risk management at the core, the business model is defined in terms of the risk appetite of the supervisory board and its shareholders. In keeping with changes in the economic and credit environment, WSW has chosen to increase its focus on credit issues.

## WSW's Capitalization And Collateral Support

WSW holds its risk capital in a mixture of cash, liquid government securities, and other liquid investments. It is restricted to investing in fixed-income instruments with a rating of at least 'AA' when the security is purchased. Currently, about 60% of the value of the pool is held in 'AAA' rated securities, and about 36% in 'AA' rated securities. While WSW's own capital remains low in relation to its guarantee obligations (0.6%; see Table 2), we take comfort from WSW's ability to call capital from participants, which is equal to 3.85% of outstanding guaranteed debt and which associations make provisions for on their balance sheets. Most importantly, we take comfort from the backstop mechanism provided by Dutch municipalities and the central government.

At December 2013, WSW had risk capital of about €487 million and committed capital (callable from housing associations) of €3.2 billion to cover repayment commitments, as well as access to interest-free loans from the government and municipalities in equal measure to ensure that it is able to meet its obligations.

Additional support is provided by the floating charge that WSW has over all property of the housing association for which it provides its guarantees. The security is in the form of legal permission, granted by associations, to claim mortgage certificates. If WSW pays on an obligation, it has access to the collateral that has been pledged to WSW and in extremis, if the organization has not been able to repay the obligation to WSW, then WSW has the right and ability to sell that collateral and recover the payments made on behalf on the organization. The value of this security exceeds

the value of guaranteed debt by more than 4x.

**Table 2**

<b>Waarborgfonds Sociale Woningbouw Capitalization Structure, 2010-2018f</b>									
<b>(Mil. €)</b>	<b>2018f</b>	<b>2017f</b>	<b>2016f</b>	<b>2015f</b>	<b>2014f</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
Guaranteed loan obligations	85,100	85,100	86,200	87,100	87,200	86,200	87,400	86,300	85,300
WSW risk capital	552	539	526	513	500	487	481	486	482
Committed capital of participants	3,226	3,226	3,270	3,301	3,309	3,200	3,300	3,200	3,284
Total capital	3,778	3,765	3,796	3,814	3,809	3,687	3,781	3,686	3,766
WSW risk capital/guaranteed loan obligations (%)	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Total capital/guaranteed loan obligations (%)	4.4	4.4	4.4	4.4	4.4	4.3	4.3	4.3	4.4

f--Forecast. Source: WSW.

## Related Criteria And Research

- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

### Ratings Detail (As Of September 11, 2014)

#### Waarborgfonds Sociale Woningbouw

Issuer Credit Rating AA+/Stable/--

#### Issuer Credit Ratings History

29-Nov-2013 AA+/Stable/--

17-Jan-2012 AAA/Negative/--

07-Dec-2011 AAA/Watch Neg/--

\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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